Benchmark Retirement Fund

Volume 10, No. 02,
February 2014

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2014

By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

1. Review of Portfolio Performance

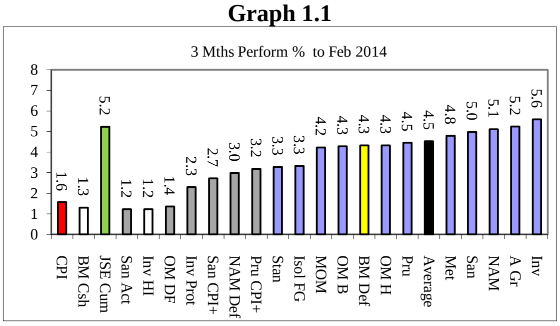
In **February** the **average prudential balanced portfolio** returned 2.06% (January: -0.34%). Top performer is Investec (3.19%), Allan Gray (1.09%) takes the bottom spot. For the 3 month period Investec is top performer outperforming the 'average' by roughly 1.1%. On the other end of the scale Stanlib' underperformed the 'average' by 1.2%.

Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced portfolios (black bar), the JSE Allshare Index (green bar), and the CPI (red bar). Benchmark investors should take note of the performance of the default portfolio (yellow bar), which now represents a combination of Prudential Namibia Inflation Plus and Allan Gray Namibia.

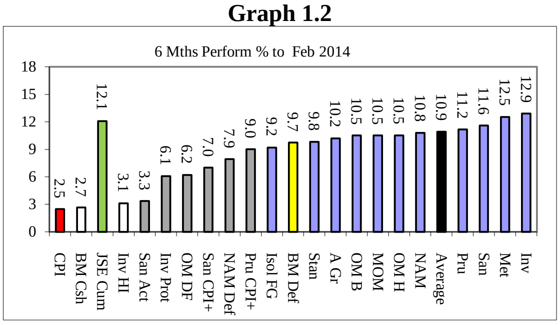
Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Average (black)
Special Mandate Portfolios	
Money market	BM Csh (no color)
Investec High Income (interest bearing assets)	Inv HI (no color)
Investec Protector	Inv Prot (grey)
Prudential Inflation Plus	Pru CPI+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Active	San Act (grey)
Sanlam Inflation Plus	San CPI+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Inv (blue)
Investment Solutions Bal Growth, (multimanager)	Isol FG (blue)
Prudential Managed	Pru (blue)
Metropolitan Managed	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
Momentum Managed	MOM (blue)
Sanlam Managed	San (blue)
Stanlib Managed	Stan (blue)

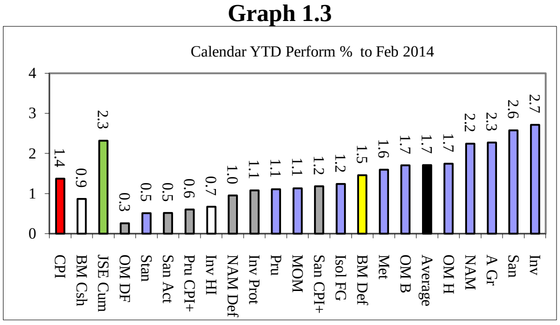
Graph 1.1



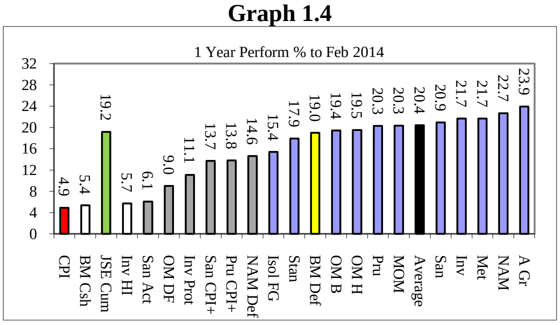
Graph 1.2



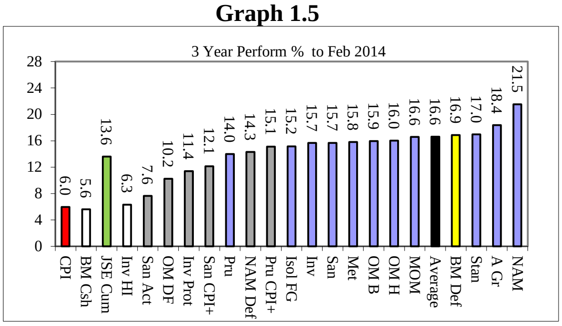
Graph 1.3



Graph 1.4



Graph 1.5



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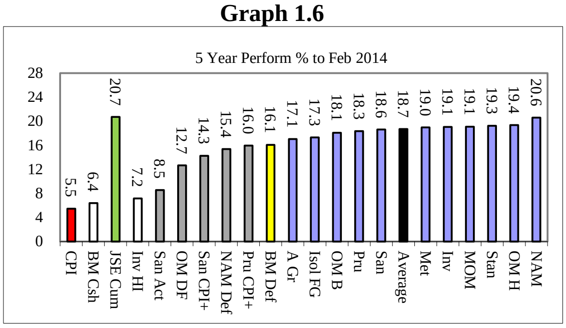
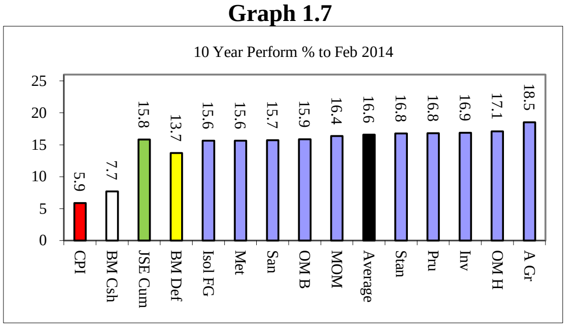
Graph 1.6

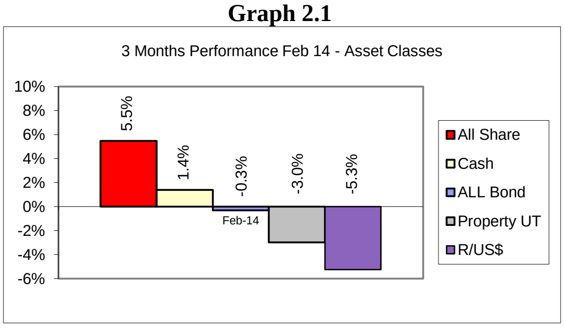


Graph 1.7

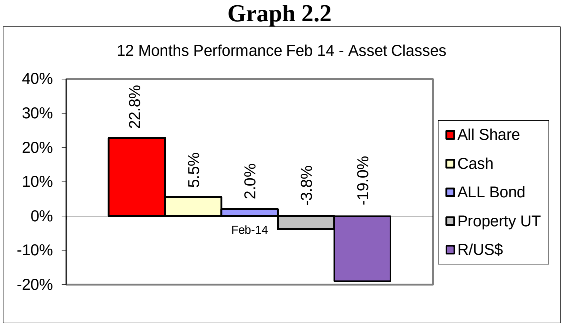


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

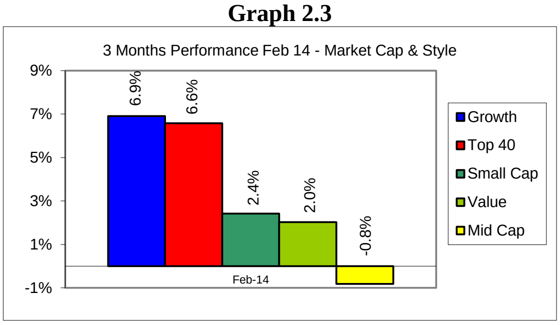
Graph 2.1



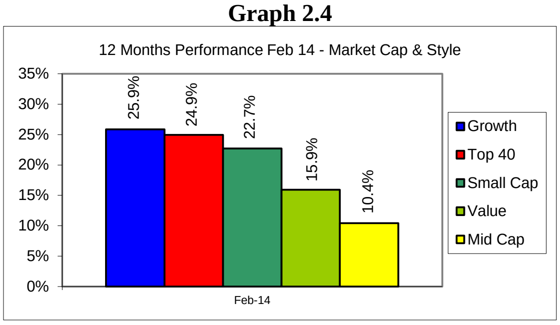
Graph 2.2



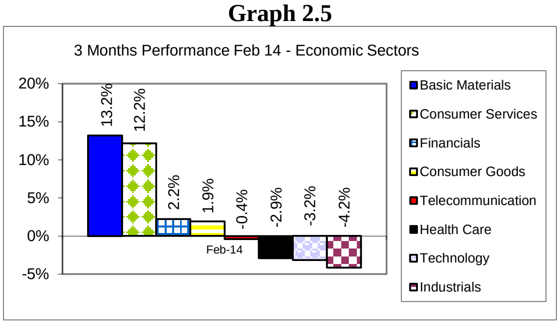
Graph 2.3



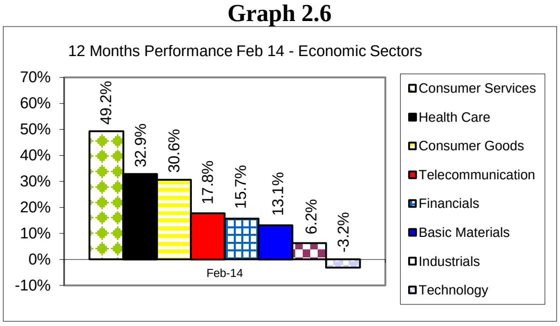
Graph 2.4



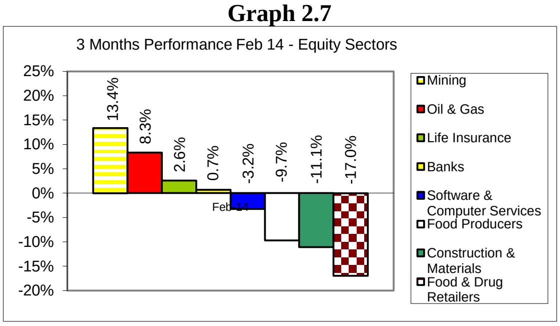
Graph 2.5



Graph 2.6



Graph 2.7



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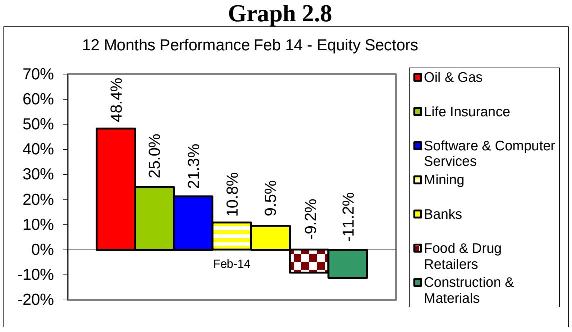
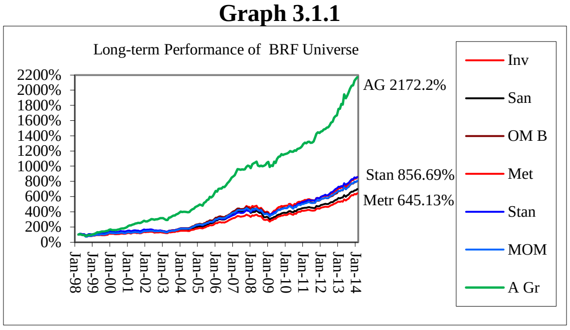
Graph 2.8



3. Portfolio Performance Analysis

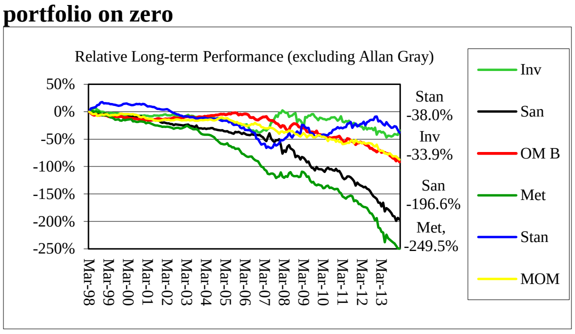
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

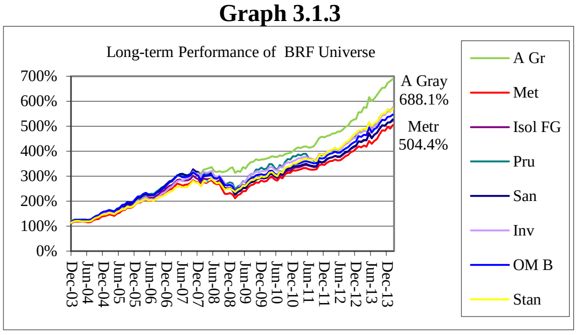


Graph 3.1.2

Cumulative performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

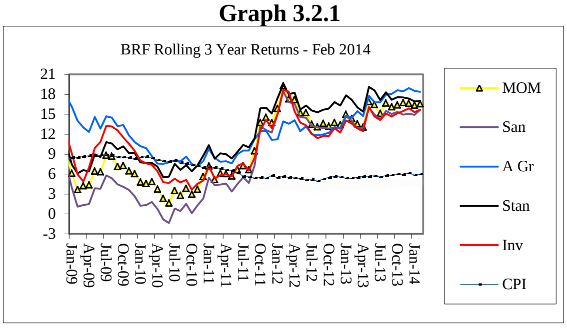


Graph 3.1.3

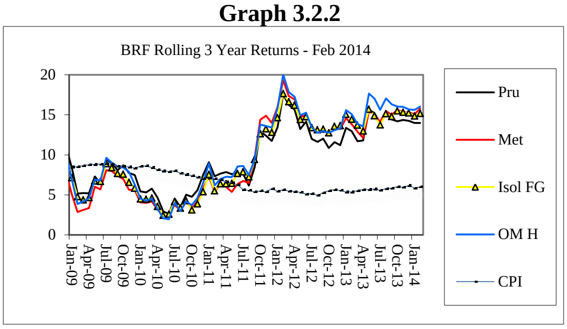


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

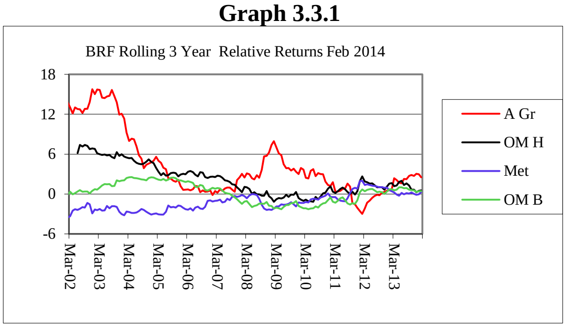


Graph 3.2.2

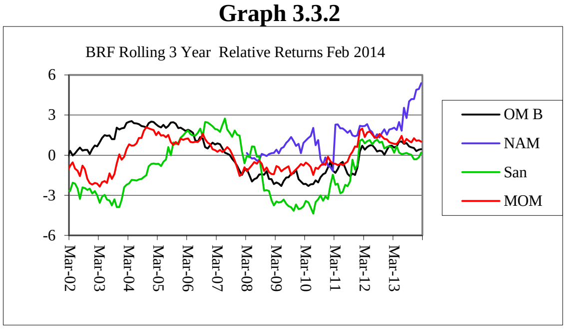


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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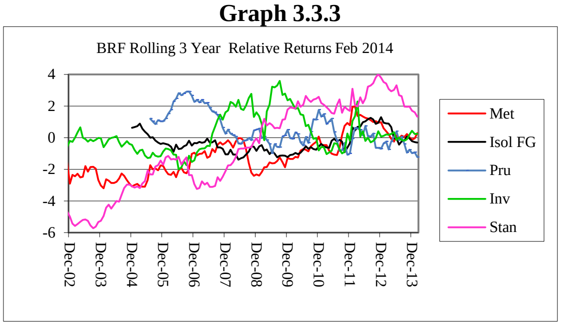
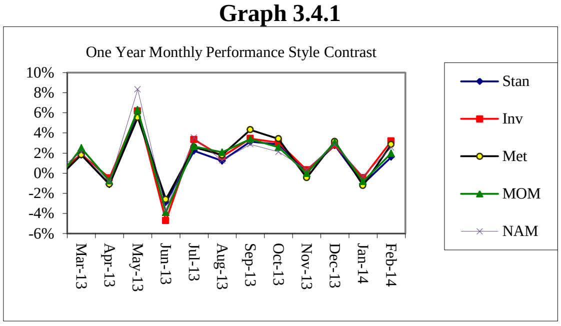
Graph 3.3.3

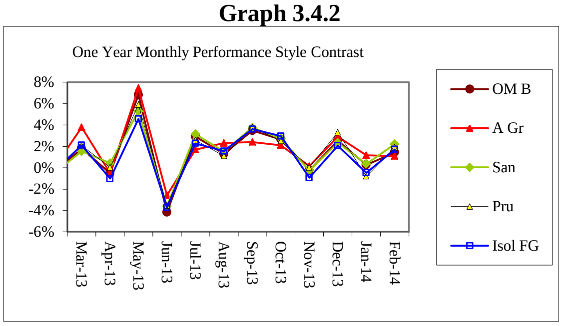


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

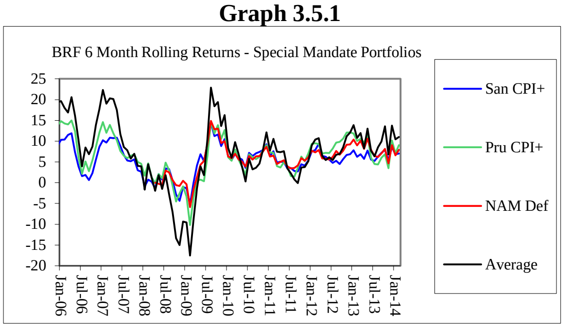


Graph 3.4.2

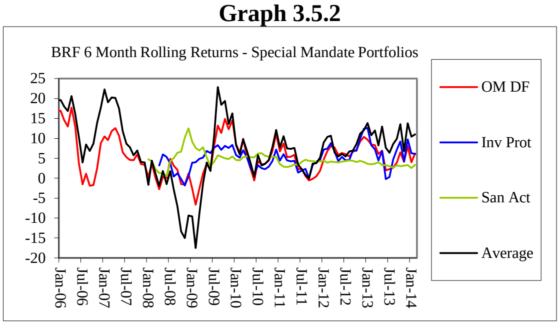


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

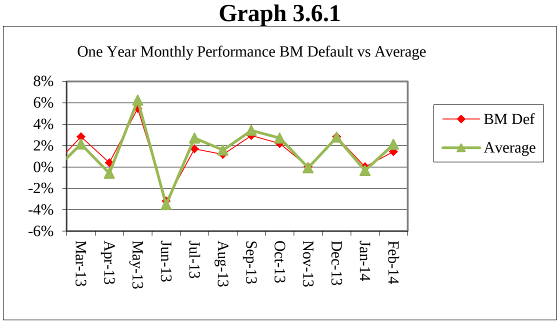


Graph 3.5.2

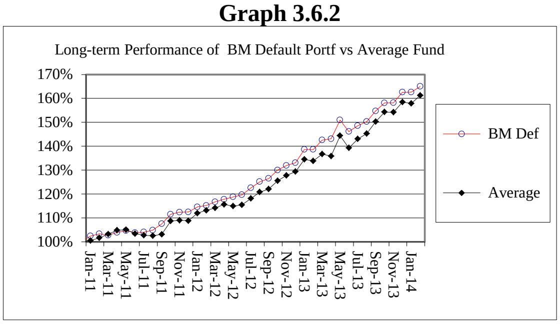


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

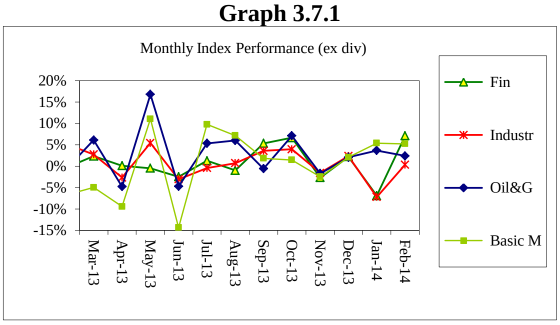


Graph 3.6.2



3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

Graph 3.7.1



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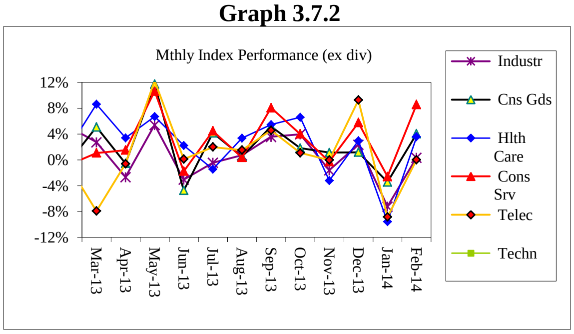
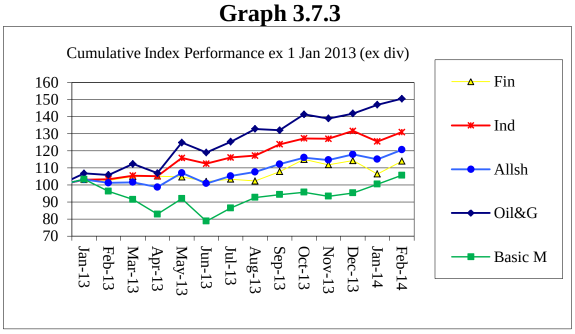
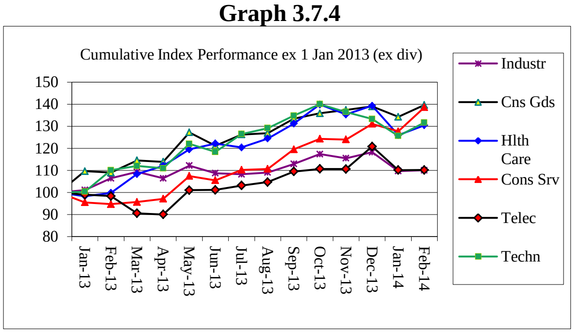
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 18.7% p.a. in nominal terms, or 13.3% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 16.1% p.a. in nominal terms, or 10.6% p.a. in real terms. The Benchmark Default portfolio is designed to produce a less volatile performance but also lower returns than the average prudential balanced portfolios with its significantly lower equity exposure (47.7% vs. 62.1% of the average prudential balanced portfolio, as at the end of December 2013) and the lower risk it consequently entails for the investor. It should be expected to underperform the average prudential balanced portfolio at times when shares outperform other asset classes and vice versa.

Considering that the average prudential balanced portfolio should deliver a real return before management fees (typically 0.75%), of roughly 6% per year, these portfolios are currently exceeding the expected long-term goal significantly over the past 5 years.

Having raised the risk profile of the Default portfolio effective the start of 2011, by replacing Metropolitan ARF with the Allan Gray Investment Trust, we would in the long-term expect the Default portfolio to sacrifice around 1% return for the benefit of lower volatility compared to the average prudential balanced portfolio, thus an expected real return before management fees (typically 0.75%), of around 5% per year. Over the past 5 years this performance objective was exceeded noticeably. Since this change was effected, the default portfolio returned a cumulative 50.8% compared to 48.6% for the average prudential balanced portfolio over this 38 month period.

Relative to the default portfolio, the performance of the prudential balanced portfolios should be more volatile due to a significantly higher equity exposure and its performance should be much closer correlated to that of the overall equity market. The default portfolio should produce a significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years March 2011 to February 2014:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	9.9%	7.4%
Best annual performance	6.8%	27.1 %	25.6 %
No of negative 1 year periods	n/a	0	0
Average of negative 1 year periods	n/a	n/a	n/a
Average of positive 1 year periods	5.8%	16.8%	16.0%

The Benchmark Default portfolio is a more conservative investment aimed at reducing negative returns and with a long-term return objective of inflation plus 5% before fees and roughly 4.3% after fees.

At this rate of return, the net contribution towards retirement by both, member and employer should be roughly 13% of remuneration, in order to achieve a reasonable income replacement ratio of 2% per year of service. It is very important that employers invested in the default portfolio are comfortable with these investment characteristics and that they should be able to create comfort amongst their employees as well.

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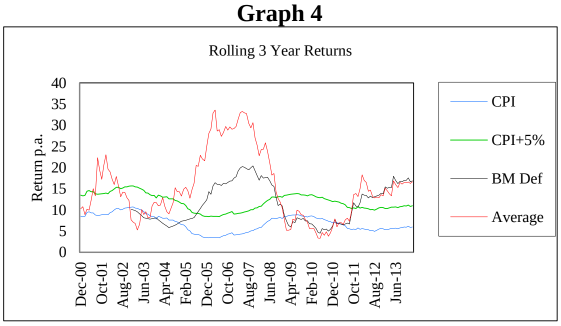
Graph 4



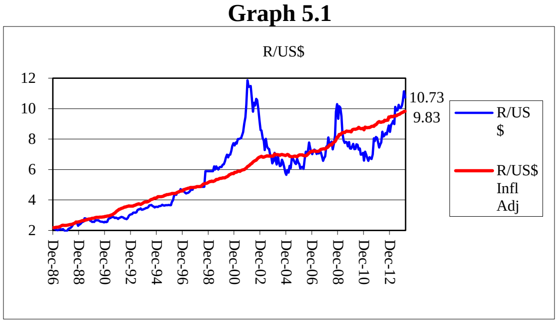
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 16.9%, the average on 16.6% vs CPI plus 5% currently on 11.0%.

5. Review of Foreign Portfolio Flows and the Rand

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 9.83 to the US Dollar while it actually stood at 10.73 at the end of February. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

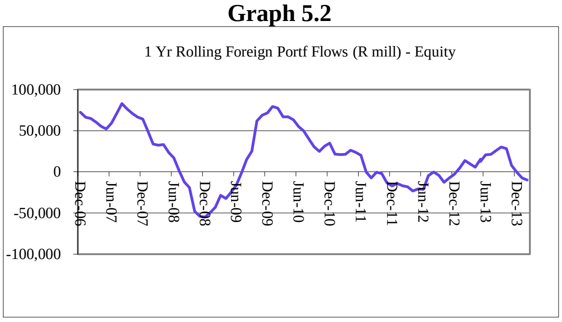
Graph 5.1



Rand loses support through foreign capital outflows

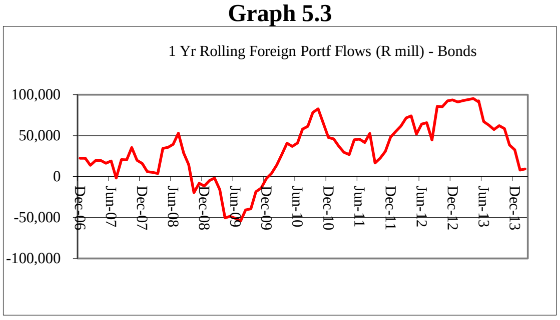
Graph 5.2 reflects a negative flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 10 bn on a year-on-year basis at the end of February (outflow of R 7.4 bn to end January). Since the beginning of 2006, foreign net investment in equities amounts to R 168 bn (end January R 162 bn). This represents roughly 1.53% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects an increase of foreign portfolio flows into bonds of R 9.3 bn over the past 12 months to end of February (R 7.9 bn over the 12 months to end of January). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 233 bn (to January just over R 225 bn).

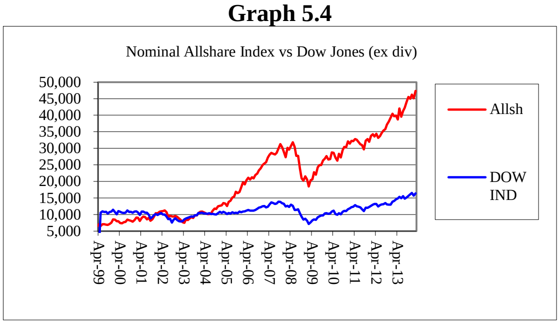
Graph 5.3



The net outflows of foreign capital from equity and fixed interest assets was R 0.7 bn for the 12 months to end February 2014 (inflow of R 0.6 bn to end January 2014), compared to R 106.5 bn for the 12 months to end February 2013 (R 95.5 bn to end of January 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 400 bn (January R 387 bn).

Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.3% per year, while the DOW Jones only grew by 3.0% per year, over a period of almost 15 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US inflation of 2.4%.

Graph 5.4



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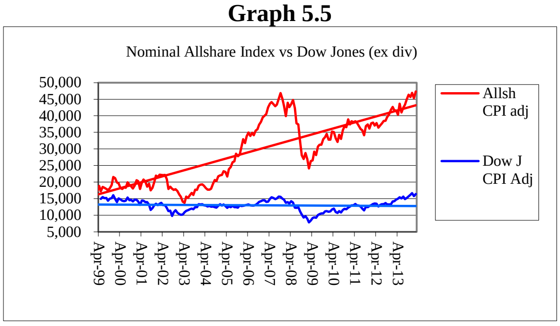
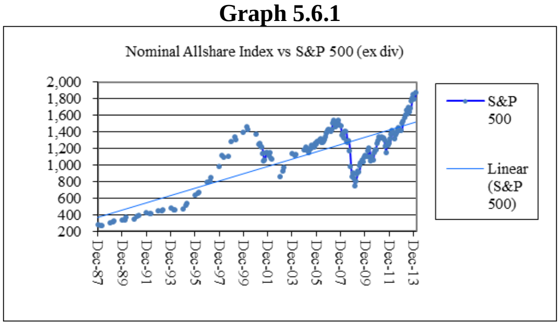
Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively. Since May 1999 the JSE Allshare Index has grown by 7.1% per year above inflation, over this period of almost 15 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW only managed to keep pace with inflation over this period, also excluding dividends.

Graph 5.5

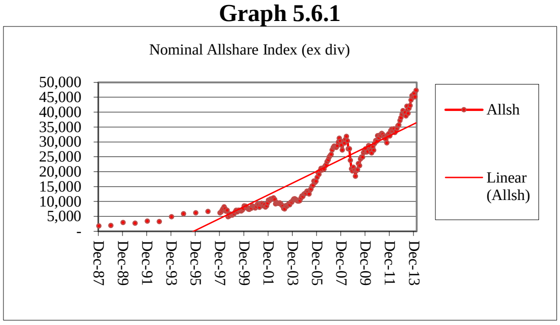


Graphs 5.6.1 and 5.6.2 reflect the more representative S&P 500, and the JSE Allshare Index since the start of 1988.

Graph 5.6.1

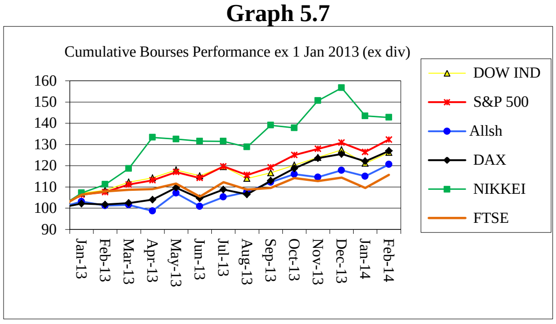


Graph 5.6.1



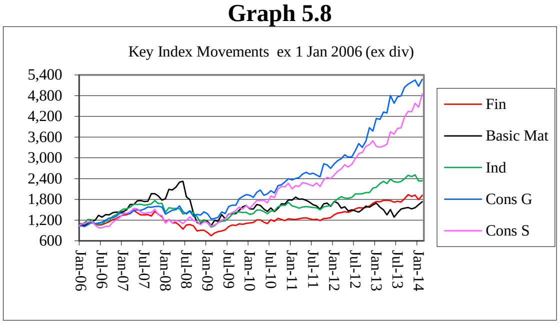
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

Graph 5.7



Graph 5.8 provides an interesting overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals.

Graph 5.8



6. Conclusion

Since the start of 1989, the S&P 500 index gained an average 7.6% per year, over this 25 year period. US inflation over this period was an average of 2.7% per year, thus producing a real return of close to 4.8 %, excluding dividends. The FTSE/JSE Allshare index gained an average of 13.4% per year while Namibian inflation over this period was an average of 8.3%, producing a real return of 4.7%, excluding dividends, on par with the real return of the S&P 500 index.

What this indicates is that despite the local 'bull run' over the past 5 years that produced a real return of 14.4% per annum, this has largely been a catch-up exercise of our local bourse when measured against the US market. It also shows that over the past 25 years, local equity markets have produced returns close to the 8% generally expected of equities in the long run, when one adds dividends of between 2% and 4% to the real return of 4.7%.

It is also interesting to compare 1 year trailing P:E ratios of these two indices, currently being 17.2 and 17.9 for the S&P 500 and the FTSE/JSE Allshare. At the end of 1988 S&P 500 P:E ratio was 11.9. Our statistics for the

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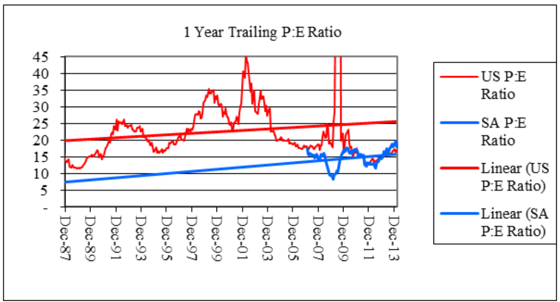
The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

FTSE/JSE P:E unfortunately does not go as far back to compare. Below is the table of these statistics including a trend line for the two data lines



Over 26 years since the start of 1988, this graph suggests that the S&P 500 P:E ratio is currently well below its long-term trendline while the FTSE/JSE Allshare is actually above its long-term trend line. Graphs 5.6.1 and 5.6.2 indicate that both markets are above their long-term trend line, the S&P 400 by 24% and the Allshare by 35%. This leads us to conclude that both markets are expensive and that caution should be exercised when investing in equities as an asset class and that share selection should be a key success factor.

Foreign investors seem to have found a level of comfort with their local investments as the result of which they are no longer withdrawing capital from our local markets. Further tapering by the US Fed is likely to result in continued but slower outflow of capital which should assist the Rand in moving towards fair value. Although the Rand has regained some ground against the US$ probably on the basis of declining foreign investment capital outflows, our indicators suggest that it is still undervalued and should revert to around 10 to the US$ over time.

The recovery of the Rand has also relieved some pressure on the SA Reserve Bank to raise interest rates in the short term although the knock-on effect of higher offshore interest rate levels will lead to local rates rising over the medium term.

This scenario should result in fair returns on equities for this year, both local and offshore while fixed interest investments are likely to produce low, possibly even negative returns in the face of rising interest rates.

On the basis of the global economic environment and our expectations of global financial markets we retain our investment call on a globally well diversified portfolio, comprising of value companies in the industrial, financial and technology sectors with strong cash flows and high dividend yields.

Resource stocks, having been in the doldrums since their peak in May 2008, should also offer buying opportunities despite our expectation of muted global commodity prices. Listed property is likely to track the performance of equities in the short-term, implying short-term opportunities but is likely to feel the impact of an increase in interest rates more severely than equities.

Pension fund members and the typical local investor would generally hold the major portion of his or her assets locally. In terms of the weighting of the equity exposure we therefore believe that the local investor should, as a matter of principle, maintain an ‘overweight’ to foreign investments in general, and to foreign equity more specifically, but looking for undervalued shares rather than equity in general. This asset class should still be able to deliver returns superior to other conventional asset classes.

Due to the continued Rand weakness however, foreign holdings should probably not be expanded at this point in time until the Rand has reverted to fair value which we consider to be at R 10 to the US$. At its current level such reversion would imply a loss of around 7% on capital moved offshore at the current exchange rate.

7. Important notice and disclaimer